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IN THE
Supreme Court of the United States

OCTOBER TERM, 1981

THE FIRST NATIONAL BANK OF SCOTIA,
KENNETH E. BURHMASTER and
LOUIS H. BURHMASTER,
Petitioners,

v.

UNITED STATES OF AMERICA DEPARTMENT
OF THE TREASURY and OFFICE OF THE
COMPTROLLER OF THE CURRENCY,
Respondents.

PETITION OF THE FIRST NATIONAL BANK OF SCOTIA, KENNETH E. BURHMASTER and LOUIS H. BURHMASTER, FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED FOR REVIEW

Did the United States Court of Appeals for the Second Circuit err, because, unlike the Fifth and Tenth Circuits, it refused to set aside a cease and desist order issued under the Financial Institutions Supervisory Act of 1966, 12 U.S.C. § 1818(b), although the record before the Court demonstrated that the order is detrimental to the financial condition of the banking institution subject to the order?

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No. 81-_____

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1981

The First National Bank of Scotia,
Kenneth E. Buhrmaster and
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v.

United States of America Department
of the Treasury and Office of the
Comptroller of the Currency,
Respondents.

PETITION OF THE FIRST NATIONAL BANK OF SCOTIA, KENNETH E. BUHRMASTER AND LOUIS H. BUHRMASTER, FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners the First National Bank of Scotia, Kenneth E. Buhrmaster and Louis H. Buhrmaster*/ respectfully pray that a writ of

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*/ The caption denotes the parties who appeared below. The First National Bank

(Footnote continued).

certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this proceeding on March 11, 1982.

OPINIONS BELOW

The opinion of the court of appeals, not reported, the decision of the Comptroller of the Currency and the accompanying order of the Comptroller of the Currency appear in the appendix hereto.

JURISDICTION

The judgment of the United States Court of Appeals for the Second Circuit was entered on March 11, 1982. This petition for certi-

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(Footnote continued from previous page).

of Scotia has no subsidiaries. Pursuant to Rules 15.1(b) and 28.1 of the rules of this Court, these representations are made in order that the Judges of this Court may evaluate possible disqualification or refusal.

orari is filed within 90 days of that date. The jurisdiction of this Court is invoked under 12 U.S.C. § 1818(h) and 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

This case arises under § 202 of the Financial Institutions Supervisory Act of 1966, as amended, (12 U.S.C. § 1818(b)) which provides in pertinent part:

Cease-and-desist proceedings

> (b)(1) If, in the opinion of the appropriate Federal banking agency, any insured bank, bank which has insured deposits, or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such a bank is engaging or has engaged, or the agency has reasonable cause to believe that the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank is about to engage, in an unsafe or unsound practice in conducting the business of such bank, or is violating or has violated, or the agency has reasonable cause to

believe that the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank is about to violate, a law, rule, or regulation, or any condition imposed in writing by the agency in connection with the granting of any application or other request by the bank or any written agreement entered into with the agency, the agency may issue and serve upon the bank or such director, officer, employee, agent, or other person a notice of charges in respect thereof. The notice shall contain a statement of the facts constituting the alleged violation or violations or the unsafe or unsound practice or practices, and shall fix a time and place at which a hearing will be held to determine whether an order to cease and desist therefrom should issue against the bank or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank. Such hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after service of such notice unless an earlier or a later date is set by the agency at the request of any party so served. Unless the party or parties so served shall appear at the hearing personally or by a duly authorized representative, they shall be deemed to have consented to the issuance of the cease-and-desist order. In the event of such consent, or if upon the record made at

any such hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the bank or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank an order to cease and desist from any such violation or practice. Such order may, by provisions which may be mandatory or otherwise, require the bank or its directors, officers, employees, agents, and other persons participating in the conduct of the affairs of such bank to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

(2) A cease-and-desist order shall become effective at the expiration of thirty days after the service of such order upon the bank or other person concerned (except in the case of a cease-and-desist order issued upon consent, which shall become effective at the time specified therein), and shall remain effective and enforceable as provided therein, except to such extent as it is stayed, modified, terminated, or set aside by action of the agency or a reviewing court.

STATEMENT OF THE CASE

Petitioner the First National Bank of Scotia ("Scotia") is a national banking association, chartered and examined by the Comptroller of the Currency ("Comptroller") under the National Bank Act, 12 U.S.C. §§ 27, 481 (1976), and is an insured bank within the meaning of the Financial Institutions Supervisory Act of 1966 ("FISA"), as amended, 12 U.S.C. § 1818 (1976). (A.R. 7).[1/] Petitioner Kenneth E. Buhrmaster is chairman of the board and chief executive officer of Sco-

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1/ The following abbreviations are used:

"A.R." is the administrative record filed in First National Bank of Scotia v. Comptroller of the Currency, No. 80-4256 (2d Cir. Apr. 9, 1981); and

"J.A." is the joint appendix filed in First National Bank of Scotia v. Comptroller of the Currency, No. 81-4222 (2d Cir. Mar. 11, 1982);

"Add." refers to the addendum to this brief.

tia, and petitioner Louis H. Buhrmaster is its president. (J.A. 7, 38).

Petitioners seek review of a decision by the United States Court of Appeals for the Second Circuit upholding a June 29, 1981, order of the Comptroller. The Comptroller's order modified -- under the circumstances described below -- a cease and desist order previously entered by the Comptroller against petitioners on November 20, 1980. (Add. C).

1. The Comptroller's Original Order.

On November 20, 1980, the Comptroller ordered Scotia, Kenneth E. Buhrmaster and Louis H. Buhrmaster to cease and desist certain banking practices found to be unsafe and unsound. The Comptroller also found that Scotia was violating section 24A of the Federal Reserve Act, 12 U.S.C. § 371d, and ordered Scotia to take remedial action. (J.A. 16-26). On April 9, 1981 the United States

Court of Appeals for the Second Circuit affirmed the cease and desist order. First National Bank of Scotia v. Comptroller of the Currency, No. 80-4256 (2d Cir. Apr. 9, 1981). The Second Circuit denied rehearing on May 20, 1981 and this Court on November 9, 1981 denied Scotia's petition for certiorari. 2/ First National Bank of Scotia v. Comptroller of the Currency, 182 S.Ct. 568 (1981).

Provisions of the November 20, 1980 cease and desist order, as amended, required the Bank to raise $1.5 million in capital by August 24, 1981 or to submit immediately thereafter a plan for selling Scotia or merg-

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2/ That petition presented the issue of whether under its lease agreement, Scotia owned the building which housed one of its branches in violation of 12 U.S.C. § 371d under this Court's holding in Frank Lyon Co. v. United States, 435 U.S. 561 (1978). That issue is not raised in this petition.

ing it with another institution.[3/]

2. Scotia's Motion to Modify.

Based upon experience subsequent to the cease and desist order, Scotia found the provisions of the Comptroller's order relating to capital to be unworkable and counterproductive in achieving the purposes of the order.[4/] Scotia moved on May 18, 1981 to

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3/ On April 17, 1981, the Comptroller sua sponte amended the November 20, 1980 cease and desist order to provide that the time in which Scotia must raise the capital would be changed from 120 days after the effective date of the order to August 24, 1981. (J.A. 128). Petitioners do not challenge the Comptroller's April 17 modification.

4/ Other provisions of the order relate to employment of a lending officer, internal controls and audits, asset and liability management, dividends, earnings and expenses, loans administration and regulatory violations. (J.A. 18-26). Scotia does not contest these provisions with which the Comptroller's most recent examination report of May 8, 1981 found Scotia to be in "technical compliance." (Add. I).

modify this provision. (J.A. 4-6).[5/]

Scotia asked that Article I be modified to require the raising of $750,000 in capital instead of $1.5 million. (J.A. 4). In support of this request, Scotia submitted evidence showing that, while Scotia was proceeding in good faith to comply with the $1.5 million additional capital requirement, subsequent circumstances were proving this requirement to be impractical and inconsistent to the capital ratios demanded of other similar national banks. (J.A. 7-15, 27-45; "Capital Adequacy Guidelines," reprinted infra as Add. D). Particularly, Scotia's shareholders were unlikely to approve a capital increase of $1.5 million as required by statute, see 12 U.S.C. § 57, and even if such approval

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5/ Scotia also moved to modify provisions of the cease and desist order requiring Scotia to correct the purported violation of 12 U.S.C. § 371d. However, Scotia does not seek review of that aspect of the decision of the court of appeals.

were obtained, Scotia could not realistically expect to sell such an amount. (J.A. 8, 42).[6/] Scotia believed that a $750,000 capital offering stood a greater chance of success, since the bank already had collected from 13 persons $428,000, which was being held by Scotia in a subordinated certificate of deposit. These funds were to be used if necessary to purchase on behalf of these 13 persons any unsold portion of a $750,000 stock offering. (J.A. 10-11).[7/]

Scotia also submitted as evidence a capital projection received from the Comptroller in the spring of 1981. (J.A. 9, 27-29). The

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6/ After the motion to modify was filed, Scotia's shareholders on May 26, 1981 rejected the proposed $1.5 million increase. (J.A. 121). Although not shown in the record, petitioners Kenneth and Louis Buhrmaster voted their shares in favor of the $1.5 million increase.

7/ Scotia's estimate of its success in selling even $750,000 proved to be overly optimistic. See infra at 16-18.

projection showed that Scotia needed only $730,000 in capital to have by year-end 1982 the same equity to total assets ratio (7.62%) as the average for its peer group, as defined by the Comptroller, of similar sized banks.[8/] This projection assumed that Scotia's growth and return on assets would continue in 1981 and 1982 at the same rate as during 1980. (J.A. 9, 27-29, 41).

Scotia stated that its proposed modified order could be entered by consent, thus mooting the then pending appeal to the Second Circuit and becoming immediately effective. (J.A. 5, 47; see 12 U.S.C. § 1818(b)(2)). Scotia requested an argument before the Comptroller, suggesting that such an argument

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8/ On December 17, 1981 the Comptroller released "Capital Adequacy Guidelines" stating that, absent specified circumstances, a capital to total assets ratio of 7% or higher would be presumed to be adequate. (Add. D).

might be in the nature of a settlement conference. (J.A. 125).

3. Response of the Comptroller's Staff to Scotia's Motion.

Counsel to the Comptroller opposed Scotia's motion to modify, but submitted his own request for modification of the cease and desist order. (J.A. 49-57, 92-93). Counsel to the Comptroller agreed to reducing the capital increase from $1.5 million to $750,000, but asked also that Scotia be required to achieve by year-end 1981, and to maintain thereafter, equity capital equal to 8% of its total assets. (J.A. 92-93). 9/ Counsel to the Comptroller neither provided any explanation of, nor submitted any evidence to sup-

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9/ Counsel for the Comptroller also moved to delete from the Comptroller's November 20, 1980 order, Article II, which required submission of a plan to sell the bank if capital were not increased as ordered. (J.A. 92).

port, the 8% figure. Counsel to the Comptroller altogether failed to address the question of whether the 8% ratio would promote or hinder Scotia's efforts to achieve financial stability and soundness.[10/] He also submitted no evidence to refute Scotia's showing that an additional $750,000 would provide Scotia with adequate capital. (J.A. 48-57).

4. The Comptroller's Decision.

On June 29, 1981, the Comptroller ruled on the cross motions to modify. The Comptroller modified Article I of the cease and desist order, as requested by his staff, to require Scotia to offer and complete by

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10/ Counsel to the Comptroller stated only that the $1.5 million capital requirement of the November 20, 1980 cease and desist order translated as of December 31, 1980 into an equity capital to total assets ratio of 8.1% and that the 8% ratio would give Scotia "flexibility" to meet its capital needs. (J.A. 94-95).

August 24, 1981 the sale of $750,000 in equity capital authorized by the shareholders and to delete Article II. (J.A. 125).[11/] The Comptroller also adopted the staff's further modification to require Scotia to "achieve and thereafter maintain a level of equity capital to total assets of at least 8 percent by December 31, 1981." (J.A. 125). The Comptroller denied Scotia's request for oral argument. (J.A. 120).

5. Events Since the Order was Modified on June 29, 1981.

On July 29, 1981, petitioners filed in the United States Court of Appeals for the District of Columbia pursuant to 12 U.S.C. § 1818(h)(2) a petition to review the Comp-

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11/ Scotia, having itself sought this modification, did not contest the requirement that it offer for sale $750,000 in equity capital.

troller's June 29 order.[12] That court, on motion of the Comptroller, transferred the review proceeding to the Second Circuit.

The Comptroller on August 20, 1981, declared effective Scotia's offering circular for $750,000 in new equity shares.[13] At the end of a 30-day preemptive offering to Scotia's shareholders and an additional 30-day

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12/ Petitioners also guarded against the possibility of review lying in the district court rather than the court of appeals, by filing on August 12, 1981 a complaint in the United States District Court for the District of Columbia. See Investment Co. Inst. v. Bd. of Governors, 551 F.2d 1270, 1277-78 (D.C. Cir. 1977). The district court dismissed the action for lack of jurisdiction, finding that the issues presented by plaintiffs' complaint are questions to be decided if, at all, by the court of appeals for the Second Circuit as it exercises its power of review under 12 U.S.C. § 1818(h)(2). First National Bank of Scotia v. United States, 503 F. Supp. 162 (D.D.C. 1982).

13/ See 12 C.F.R. §§ 16.3(a) and 16.6 (1981). The Comptroller's review of Scotia's offering circular consumed two months.

offering period to the public, $640,740 remained unsold. Shares totalling $430,000 then were sold to those who in May 1981 had placed funds for that purpose in a subordinated certificate of deposit.[14/] Scotia's capital was increased by $540,260, effective October 21, 1981. (Add. E). An extension of the offering period until December 31, 1981, resulted in the sale of only an additional $3,200 of stock.

On October 30, 1981, after the limited success of the offering circular became apparent, Scotia wrote the Comptroller's Regional Administrator pointing out that the required 8% capital to total assets ratio could not be achieved by selling stock. (Add. F). Achieving the required ratio could

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14/ Shortly after the motion to modify was filed with the Comptroller on May 18, 1981, another $2,000 was added to the subordinated certificate of deposit, bringing its total to $430,000.

be accomplished only by reducing assets. (Id. at F-1). Such a reduction in assets, however, would injure the bank because it could be achieved only by disposing of the high-yielding assets, which now constitute the principal source of the bank's earnings. The Regional Administrator's response of November 17, 1981, did not dispute the facts stated by Scotia, but offered no helpful guidance as to what Scotia should do. (Add. G).

This situation remains unchanged to the present. On March 18, 1982, Scotia advised the Comptroller that its best good faith efforts to sell additional stock were not being successful and were draining financial resources. (Add. H). Scotia stated that the only alternative to achieve the 8% requirement would be to sell bank assets. (Id. at H-3). Scotia advised that, after already shrinking assets from $70 million in early

1978 to their present $45 million, Scotia would have to sell another $5,133,663 in assets to achieve the 8% ratio. (Id.; Add. at I-7-8).[15/] But, Scotia pointed out another $5 million of assets could be sold only at a financially ruinous loss to the bank. (Add. at H-4-5). The Comptroller continues to fail to respond to Scotia's letter of March 18, 1982 or to otherwise provide guidance on a means of achieving the 8% ratio without injuring Scotia's financial well-being.

On March 11, 1982 the Second Circuit denied Scotia's petition for review. First National Bank of Scotia v. Comptroller of the Currency, No. 81-4222 (2d Cir. Mar. 11, 1982) (reprinted in the Addendum hereto as

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15/ Addendum I responds to the Comptroller's advice to Scotia on April 14, 1982 that it was contemplating enforcement proceedings for failure to comply with the modified cease and desist order.

Add. A). The court of appeals held that the 8% requirement is "well within the Comptroller's broad authority to require actions to remedy under capitalization resulting from unsafe and unsound banking practices" and that prior affirmance of the $1.5 million additional capital requirement necessarily entailed approval of the 8% requirement. (Id. at A-6-7). The court did not examine the impact of the 8% requirement on Scotia's financial well-being or on the bank's efforts to improve its earnings and thus also to improve its capital. Neither did the court specify any means by which Scotia could comply with the order without suffering financial hardship. (Add. at A-8). Petitioners now seek a writ of certiorari to obtain review of the decision of the Second Circuit.

REASONS FOR GRANTING THE WRIT

This petition presents a significant question of first impression to this Court regarding the scope of the Comptroller's cease and desist authority under 12 U.S.C. § 1818(b). This authority was created by FISA, and is only beginning to receive judicial interpretation. See Gulf Federal Savings & Loan Association of Jefferson Parish v. Federal Home Loan Bank Board, 651 F.2d 259, 263 (5th Cir. 1981), petition for cert. filed, 50 U.S.L.W. 3784 (U.S. Mar. 19, 1982) (No. 81-1744).[16/] In two other cases, the courts of appeals recently reversed agency

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16/ FISA provided cease and desist authority either under § 1818(b) or similar provisions for various federal agencies charged with supervising financial institutions. See 12 U.S.C. §§ 1818(b), 1464(d), 1786(e). These agencies are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, the Federal Savings and Loan Insurance Corporation and (since 1970) the National Credit Union Administration.

cease and desist orders because they did not carry out FISA's purpose of promoting financially sound and stable financial institutions. Gulf Federal, 651 F.2d at 263-65; Otero Savings and Loan Association v. Federal Home Loan Bank Board, 665 F.2d 279, 288-89 (10th Cir. 1981).

In contrast, the Second Circuit's decision in the instant case upheld the eight percent ratio requirement although the undisputed record demonstrated that the requirement would be detrimental to Scotia's financial soundness. The failure of the Second Circuit to evaluate whether the Comptroller's modification operated, as required by § 1818(b), to improve or preserve Scotia's finances conflicts with the standard of judicial review enunciated in Gulf Federal and Otero. This standard of review serves the public interest of avoiding bank failures, particularly in this time of economic reces-

sion and high interest rates, by ensuring that the Comptroller's orders assist, not hinder, troubled banks in their recovery efforts. The Court should grant this petition to clarify that the cease and desist authority accorded the Comptroller under 12 U.S.C. § 1818 is limited to orders that promote financial soundness of the banking institutions involved.

A. The Purpose Of 12 U.S.C. § 1818(b) Is To Promote Financial Stability Among Federally Chartered Banks.

The Comptroller charters and supervises national banks. See 12 U.S.C. §§ 1, 27, and 481. His primary duty is "to supervise the banking system for the protection of the public and the national economy as a whole." In re Franklin National Bank Securities Litigation, 478 F. Supp. 210, 215 & 217 (E.D.N.Y. 1979). Prior to enactment of FISA, the Comp-

troller's only remedies for a recalcitrant bank or one in financial difficulty was to appoint a conservator, 12 U.S.C. §§ 203, 205, or to declare it insolvent and take possession of the assets by appointing a receiver, 12 U.S.C. §§ 191-192. S. Rep. No. 1482, 89th Cong., 2d Sess., reprinted in [1966] U.S. Code Cong. & Ad. News 3532, 3537. Cease and desist authority was enacted in 1966 to permit the Comptroller to correct unsafe and unsound banking practices before the offending institution's condition deteriorated so badly that a conservator or receiver became necessary. Id.; see Gulf Federal, 651 F.2d at 262-63. Congress' intent was to grant the Comptroller and other agencies supervising financial institutions "'additional flexible and effective supervisory powers. . . ' within carefully guarded limits, in order to make sure that our banks and savings and loan associations would continue to serve the Nation

effectively and well." Otero, 665 F.2d at 288 (quoting from S. Rep. No. 1482, 89th Cong., 2d Sess., reprinted in [1966] U.S. Code Cong. & Ad. News 3532, 3538) (emphasis added by the court).

Two circuits recently have held that the legislative history of FISA mandates that this cease and desist authority is limited to actions that preserve financial integrity of the subject financial institutions. See Gulf Federal, 651 F.2d at 265; Otero, 665 F.2d at 287-88. In Gulf Federal the Fifth Circuit struck down a cease and desist order of the Federal Home Loan Bank Board requiring a federal savings and loan association to cease from interest calculations on a 360-day a year basis since it was inconsistent with representations to customers contained in loan contracts that interest was calculated on a 365-day year basis. 651 F.2d at 261. The Board also had ordered Gulf Federal to

repay the excess interest. The Fifth Circuit, after extensive review of the legislative history, held that, to be sustained, cease and desist orders must alleviate those practices which threaten financial injury to the association and preserve the financial integrity of the subject institution. Id. at 265. The court, noting that the order requiring the association to repay interest did not promote, but in fact threatened injury to, the association's finances, set aside the cease and desist order as beyond the authority of the Bank Board. Id. The Solicitor General and the bank regulatory agencies are seeking a writ of certiorari to review the Fifth Circuit's decision. 50 U.S.L.W. 3784 (1982) (U.S. March 19, 1982)(No. 81-1744).

The decision in Otero, imposes a similar standard of judicial review for cease and desist orders. The Tenth Circuit upheld a saving and loan association's challenge to the

Federal Savings and Loan Insurance Corporation's remedial authority to place a moratorium on the asosciation's offering of a negotiable order of withdrawal account in order to restore the competitive balance that had been upset when the association offered such accounts prior to being statutorily authorized to do so. 665 F.2d at 288. The Tenth Circuit also conducted an extensive analysis of the legislative history of FISA. It concluded that the cease and desist authority was intended only to stop unsound practices and to redress the effects of unlawful conduct in an "expeditious and effective manner." Id. at 288 (emphasis added). The authority did not give the Board a "mandate to use whatever means seems desirable. . ." Id. at 288. The Board's remedial cease and desist authority is limited to those actions which prevent future abuses and reverse "the direct, identifiable effects of the past

practices on the bank's financial soundness." Id.[17/]

B. The Eight Percent Total Capital To Assets Ratio Requirement Disserves The Remedial Purpose Of 12 U.S.C. § 1818(b).

In conflict with the standard enunciated in Gulf Federal and Otero, the Second Circuit failed to review the Comptroller's imposition of the eight percent ratio requirement to determine whether, on the record before it, the requirement reversed the impact of past unsound practices on the Bank's capitalization

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17/ Cf., Fidelity Savings and Loan Association v. The Federal Home Loan Bank Board, No. 82-1592 (N.D.Ca. June 3, 1982), setting aside the appointment of a receiver for a financially troubled federally insured savings and loan association because the statutory requirements for a receivership were not met.

and promoted the financial integrity of the Bank.[18/]

It is not disputed that Scotia is unable to sell additional shares and that, as a result, the only immediate means to achieve an eight percent ratio is to sell bank assets to its financial detriment. This bank, like mutual savings banks and like many other

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18/ The Second Circuit essentially adopted the Comptroller's post hoc rationale that the requirement differed little from the original $1.5 million additional equity capital requirement but provided Scotia with more flexibility to improve its capital position. First National Bank of Scotia v. Comptroller of the Currency, No. 81-4222 (2d Cir. Mar. 11, 1982). The Second Circuit adopted this reasoning although the Comptroller had already found that the $1.5 million capital requirement was infeasible and acknowledged that $750,000 in additional capital may be adequate. (J.A. 123-25). As a result, the Second Circuit's decision does not resolve the confusing and contradictory aspects of the Comptroller's order, but suffers from the same infirmity. Both decisions are barren of any evaluation of the impact of the eight percent requirement on Scotia's finances.

small commercial banks, had acquired a large volume of long-term assets, primarily mortgage loans and investment securities, at interest rates that now are substantially below the current cost of money. See 58 Cong. Rec. 5308-09 (1982) (statement of Sen. Garn). These low-yielding assets cannot be sold in today's market except at discounts so deep as to cause significant capital losses to Scotia. (See Add. at H-3-5). Since January 1978 Scotia already had reduced its assets from $70 million to $45 million. (Id.). It would have to sell another $5,113,663 in assets at book value to achieve the eight percent ratio. (Id. at H-3). Since low-yielding assets cannot be sold at book value, any further reduction of total assets "could be achieved only by disposing of high-yielding assets, which now constitute the principal source of the bank's earnings. "

(Add. at F-1).[19] These earnings are the key to a healthy bank, including additions to its capital.[20] Impairment of Scotia's earning power would severely injure Scotia's financial condition, particularly over the long term.[21]

19/ These earnings play a significant role in Scotia's efforts to improve its financial position. Under the now uncontested provisions of Article X of the cease and desist order, all of the Bank's earnings are retained as capital unless the Comptroller's Regional Administrator approves the payment of dividends. (J.A. at 136).

20/ Accordingly, the Comptroller's argument to the Second Circuit that selling high-yielding assets will increase Scotia's earnings is nonsensical. Res. Br. at 26. If it sells its high-yielding assets, Scotia will have no earnings. For the same reason, selling assets would prevent Scotia from attaining the ratio by retaining earnings since it would have no earnings to retain.

21/ As recognized by the Comptroller's November, 1981 examination report, Scotia's financial position, including the condition of its assets and its earning power, has improved substantially since the original cease and desist proceed-

(Footnote continued).

In spite of this record, the court of appeals did not examine the impact of the eight percent requirement on the financial position of Scotia. Had it done so, the

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(Footnote continued from previous page).

ings were instituted. (Add. at I-13-16). The examination report states:

> Improvement has been noted in the reduced volume of criticized assets, reduced reliance on rate sensitive deposits and in the liquidity and funds management areas.
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> * * * *
>
> Management's considerable efforts to improve earnings have resulted in a decrease both in the level of operating losses and in the level of loan losses.
>
> As noted above, the level of criticized assets continues to decline. This decline is primarily attributable to management's concerted efforts to clear up problem loans. . . . Another area of notable improvement is the decrease in assets classified loss.

(Footnote continued).

court of appeals would have found that the eight percent requirement does not in "an expeditious and effective manner" redress the effects on Scotia's capitalization of past practices, but has the opposite effect. It

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(Footnote continued from previous page).

* * * *

> The quality and capacity of active management has shown improvement, particularly in the lending area.
>
> * * * *
>
> The bank's funds and liquidity management practices and procedures are also improved. As of examination date, the bank was in a slightly liability sensitive position. The reliance on rate sensitive deposits has declined substantial ly. Acceptable funds management procedures have been developed and implemented. The bank's liquidity position is calculated on a weekly basis and is considered adequate as of examination date.

Achieving the eight percent requirement would be a major setback to Scotia's heretofore successful recovery efforts.

impedes Scotia's efforts to improve its capitalization and overall financial condition to the extent that the bank may be forced to the brink of financial ruin.[22/] Otero, 665 F.2d at 288. As such, the eight percent ratio requirement is not corrective, but punitive in nature.

Accordingly, the Second Circuit's decision conflicts with the purpose of FISA as recognized by Gulf Federal and Otero. Application of the proper standard of judicial review of orders issued under § 1818(b) requires the eight percent ratio requirement to be set aside as contrary to the purpose of

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22/ In contrast to the Comptroller's position, the Comptroller's own Regional Administrator agrees with Scotia that a prudent expansion of Scotia's total assets funded by the acquisition of rate-sensitive liabilities should be undertaken. (Add. J). As the Regional Administrator acknowledged, however, this otherwise prudent course is constrained by the requirement for an eight percent capital to asset ratio. (Id. at J-2).

promoting financially sound banking institutions and, therefore, beyond the authority of the Comptroller.

C. Proper Interpretation of 12 U.S.C. § 1818(b) Is of National Significance.

The need for reviewing courts to require that cease and desist orders preserve or promote the financial well-being of the subject institutions is of nationwide importance. There are an enormous number of institutions which, like Scotia, have experienced severe financial difficulties resulting from possessing large, long-term, low yielding portfolios of home mortgages in a time of high and volatile money market interest rates. 58 Cong. Rec. at 5308-09. This problem is of such dimension that Congress now is considering legislation to assist the many financially troubled institutions that engage in mort-

gage lending.[23/] See 58 Cong. Rec. at 5308-09; S. 2531, 97th Cong., 2d Sess., 58 Cong. Rec. 5309-10 (1982). The purpose of the legislation "is to provide much needed assistance to financial institutions engaged in mortgage lending." 58 Cong. Rec. at 5308. In introducing the Senate bill, Senator Jake Garn, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, noted

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23/ The Senate bill would permit the Federal Deposit Insurance Corporation to "increase or maintain the capital of a qualified institution by making periodic purchases of capital instruments. . ." S.2531, 97th Cong., 2d Sess., 58 Cong. Reg. 5309-10 (1982). A "qualified institution" would include a national bank which, like Scotia, had operating losses in the last two quarters and 20 percent or more of its assets invested in residential mortgages or securities backed by such mortgages. Id. A bank meeting these qualifications would receive assistance if the bank's equity were three percent or less of its total assets. Id. The House has passed a similar bill, H.R. 6267. 62 Cong. Rec. 2451-74 (1982).

that thrift institutions and savings banks, such as Scotia,

> have served the savings and housing credit needs of consumers for decades. They have provided the means through which millions of Americans have attained the goal of homeownership. Unfortunately, because of the fact that they have served their mandated purposes so well, they have been less able than other financial institutions to withstand the economic turmoil and uncertainty of the past several years.
>
> Their long-term fixed-rate mortgage loans have become millstones on their financial statements, yielding much less than these institutions have to pay for the short-term market rate deposits which have become the primary funding vehicle for thrift operations.

Id. Senator Garn remarked that "in 1981 savings banks lost $1.5 billion resulting in a decline in the industry net worth position from 6.6 percent at year end 1980 to approximately 5.7 percent currently." Id.

The Comptroller himself favors this legislation, acknowledging that the problems facing financial institutions are large scale

and "severe." (Add. K). He agrees that the problems arise from "the impact on earnings of a rapid increase in interest rates on a maturity-mismatched portfolio." (Id. at K-4). Yet the Comptroller's solution in this case would exacerbate this problem with regard to Scotia, and could, by forcing the bank to sell assets at a loss, push it to the brink of failure. This is the very result that Congress, with the Comptroller's support, is seeking to avoid for all banks like Scotia.24/

24/ The Comptroller's actions with regard to Scotia are inconsistent with his testimony in support of S. 2531 and his own capital adequacy guidelines for banks such as Scotia. The Bank's current equity capital to asset ratio is 7.09 percent. (Add. at H-1). This is above the 7 percent advanced by the Comptroller's own guidelines to be adequate for the safe operation of banks that are the size of Scotia. (Add. D). The financial assistance in the proposed legislation supported by the Comptroller, would not be triggered until a bank's ratio

(Footnote continued).

The present economic condition of the banking industry mandates now, more than ever, that the Comptroller's cease and desist authority not be employed in such a counter-productive fashion. The public interest requires that reviewing courts evaluate cease and desist orders to ensure that they assist, not hamper, a bank's financial recovery. This standard of review would avoid the injury resulting to a bank's depositors if the financial regulatory agencies use their cease and desist authority to push an already troubled bank to the brink of insolvency. The Court should grant this petition for certiorari to rectify the court of appeals' fail-

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(Footnote continued from previous page).

sank to three percent. The Comptroller has never advanced any reason as to why Scotia cannot operate safely with its present ratio or why Scotia is subject to treatment than that accorded or proposed for other similar banks, including those in financial difficulty.

ure to conduct such an evaluation.[25/]

25/ This case also presents an important question regarding the authority of the Comptroller to substantially modify cease and desist orders without a hearing. Section 1818 requires that a bank, officer, employee, agent or other person participating in the conduct of affairs of a bank be provided with notice and hearing, including the opportunity to examine witnesses, before the Comptroller can take affirmative action against them in a final cease and desist order. 12 U.S.C. § 1818 (1976). These provisions ensure that the requirements of due process are met; "the touchstone of due process is protection of the individual against arbitrary action of the government." Feinburg v. Federal Deposit Insurance Corp., 420 F. Supp. 109, 118, 121 (D.D.C. 1976).

The eight percent ratio requirement was imposed on the Bank in violation of § 1818 and fundamental due process requirements. Id. The eight percent ratio requirement was not at issue during the 1980 cease and desist hearings and was not addressed by either side. The eight percent requirement is substantially different in form and effect from the capital provisions of the November, 1980 cease and desist order. Section 1818 and the due process clause prevent the Comptroller from modifying the final cease and desist order to impose a new affirmative requirement upon Scotia in

(footnote continued).

CONCLUSION

For the foregoing reasons, Petitioners The First National Bank of Scotia, Kenneth Buhrmaster and Louis Buhrmaster respectfully pray that a writ of certiorari be granted.

Respectfully submitted,

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and Louis H. Buhrmaster

(Footnote continued from previous page).

the form of the eight percent ratio without formal notice and hearing. See Civil Aeronautics Board v. Delta Air Lines, Inc., 367 U.S. 316, 329-32 (1961).

ADDENDUM A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the eleventh day of March, one thousand nine hundred and eighty-two.

Present: Honorable Jon O. Newman,
Honorable Richard J. Cardamone,
Circuit Judges.

Honorable Ellen Bree Burns,*
District Judge.

THE FIRST NATIONAL BANK OF SCOTIA, ET AL.,
Petitioners,

v. 81-4222

UNITED STATES OF AMERICA, DEPARTMENT OF THE TREASURY, OFFICE OF THE COMPTROLLER OF THE CURRENCY,
Respondent.

O R D E R

The First National Bank of Scotia and two of its principal officers petition

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*/ Of the United States District Court for the District of Columbia, sitting by designation.

for review of an order of the Office of the Comptroller of the Currency, which (1) denied petitioners' motion to modify a cease and desist order previously entered against them and upheld by this Court, and (2) modified the order to require the Bank to maintain an 8% ratio of equity capital to total assets. The Comptroller issued the cease and desist order on November 20, 1980 when, after an administrative hearing, he determined that the Bank had engaged in numerous unsafe and unsound banking practices and had violated 12 U.S.C. § 371d (1976) (prohibiting national bank from investing in bank premises in excess of capital stock without approval). See 12 U.S.C. § 1818(b) (1976). More specifically, the Comptroller found that the Bank's practices had caused its equity capital to become so inadequate as to pose a likelihood of a future capital insolvency and that the lease agreement between the Bank and the J.H.

Buhrmaster Company (a company wholly owned by the family of the Bank's principal officers) was a sham transaction to hide the Bank's illegal investment in its Erie Boulevard premises in Schenectady, New York. The cease and desist order required the Bank to raise $1,500,000 in new equity capital and to correct the violation of 12 U.S.C. § 371d (1976). On petition for review to this Court, we affirmed the order of the Comptroller of the Currency. No. 80-4256 (2d Cir. Apr. 9, 1981), cert. denied, 50 U.S.L.W. 3376 (Nov. 9, 1981). Our prior ruling stated:

> Petitioners do not dispute the Comptroller's finding that the Bank had been operating with insuffi cient equity capital and that without an additional $1.5 million in equity capital the Bank was likely to suffer a capital insolvency in the foreseeable future.
>
> . . .
>
> [T]he statute gives the Comptroller broad authority to identify unsafe and unsound banking practices . . . and equally broad authority to fashion remedial orders to require

banks not only to "cease and desist" from such practices, but also to take affirmative action to correct the conditions resulting from those practices.

In view of the extreme circumstances present in this case and the broad remedial purpose of the statute, we hold that the Comptroller did not exceed his authority in ordering petitioners to increase the Bank's capitalization by $1.5 million and in ordering petitioners to submit "realistic proposals" for the sale or merger of the Bank in the event it were unable to raise the required capital

. . .

We also hold that the Comptroller's finding that the Bank has violated 12 U.S.C. § 371d (1976) by investing in bank premises on Erie Boulevard in Schenectady, New York, is supported by substantial evidence. . . .

The evidence clearly supported the Comptroller's finding that the so-called lease agreement between the Bank and the J.H. Buhrmaster Co. dated April 11, 1974 was not a true lease but a device intended to hide the Bank's illegal investment in the Bank's premises. . . . We hold that the Comptroller's finding is supported by uncontroverted evidence of deceptive practices which petitioners engaged in to hide the

> true nature of the investment agreement.
>
> Where the Comptroller's finding of a violation is supported by substantial evidence, he is given broad discretion to order remedial measures. . . . We hold that the Comptroller did not act in an arbitrary and capricious manner; nor did he exceed his authority by ordering the Bank to stop making payments under the sham agreement found to be unsound; nor by ordering the named directors of the Bank to take affirmative measures to correct the conditions caused by those improper payments by making restitution for improper payments the Bank is otherwise unable to recoup.

On May 18, 1981, the Bank moved to modify the cease and desist order to require the raising of only $750,000 in capital instead of $1.5 million, to permit the Bank to make certain payments allegedly due J.H. Buhrmaster Co. under the lease, and to replace the deadline for sale of the premises with a best efforts requirement. The Office of the Comptroller denied the request for these modifications, but did modify the order, on motion

of counsel to the Comptroller, to eliminate the previous requirement that the Bank raise $1,500,000 in new equity capital and to substitute instead a requirement that the Bank maintain an 8% ratio of equity capital to total assets. (An additional $1.5 million in equity capital in late 1980 would have resulted in an 8.1% ratio of equity capital to total assets). This modification gives the Bank the flexibility to satisfy the cease and desist order by a combination of decreasing assets and increasing equity capital rather than solely by increasing equity capital by $1.5 million. In addition, the order was modified to require the Bank to offer for sale $750,000 in equity capital previously authorized by the shareholders; the Bank does not challenge this requirement. We deny the petition to review.

1. The requirement of an 8% ratio of equity capital to total assets is well within

the Comptroller's broad authority to require actions to remedy undercapitalization resulting from unsafe and unsound banking practices. Petitioners object to the 8% figure because the average capital/total assets ratio of banks of similar size and location is 7.62% and because the Comptroller's recent guidelines on capital adequacy for well-managed banks not under special supervision require a ratio of only 7%. While these ratios may be appropriate for banks under normal circumstances, it is not error for the Comptroller to require a higher than average ratio for a bank that has been found to be in danger of capital insolvency because of unsafe and unsound banking practices. Our earlier holding that a requirement of a $1.5 million increase in equity capital was a proper exercise of the Comptroller's remedial authority necessarily entails our approval of the more flexible 8% ratio requirement. For

the same reasons, it was not error to refuse the Bank's request to modify the order to require an increase of only $750,000 in capital equity.

Nor is the Comptroller's remedial authority curtailed at the first sign of an improvement in the Bank's financial picture. The Comptroller therefore did not err in determining that the Bank's projection of an improved financial picture was insufficient reason to relax the requirements of the cease and desist order. Even if the Comptroller could not ensure the financial integrity of the Bank by taking steps that imposed hardships on the Bank or its shareholders, we find sufficient evidence in the record to support the Comptroller's conclusion that there are a number of ways for the Bank to comply with the 8% ratio requirement without undue hardship.

2. We have already held that the Comp-

troller's original finding of a violation of 12 U.S.C. § 371d (1976) was supported by substantial evidence, and that the Comptroller's ordering the Bank to stop making payments under the lease was within the Comptroller's remedial authority. We see no reason to permit petitioners to relitigate that question. Petitioners point to new evidence that in another context the Comptroller viewed J.H. Buhrmaster Co. rather than the Bank as the actual lessor of the Erie Building, but in that context the Comptroller had no need to reconsider the legal relationship of the Bank and J.H. Buhrmaster Co. with respect to the lease. The Comptroller was merely evaluating the financial condition of the J.H. Buhrmaster Co. in a context that did not require analysis of the company's relationship with the Bank.

The petitioners' remaining contentions are without merit. The petition for

review is denied. The mandate shall issue forthwith.

/s/ Jon O. Newman
/s/ Richard J. Cardamone
Circuit Judges.

/s/ Ellen Bree Burns
District Judge.

ADDENDUM B

UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

IN THE MATTER OF THE FIRST NATIONAL BANK OF SCOTIA, SCOTIA, NEW YORK; KENNETH E. BUHRMASTER; and LOUIS H. BUHRMASTER	Docket No. AA-EC-80-1

ORDER

Counsel for respondents in this case filed a motion on May 18, 1981, requesting that the Comptroller of the Currency ("Comptroller") modify his final order to cease and desist ("order"). Counsel to the Comptroller filed a motion on June 11, 1981, also requesting that the Comptroller modify his order, specifically Articles I and II as amended by the Comptroller on April 17, 1981. On June 15, 1981, counsel for respondents

moved for oral argument on the parties' respective motions.

The parties' motions and supporting papers requesting modification of the Comptroller's order are sufficient to enable the Comptroller to rule on the requests. Moreover, further delay of corrective action in these proceedings is unwarranted and undesirable. Accordingly, respondents' request for oral argument before the Comptroller is denied.

Article I of the original order required the First National Bank of Scotia, New York ("Bank") to submit to the Regional Administrator of National Banks for the Second National Bank Region, New York ("Regional Administrator") an acceptable program to raise at least $1,500,000 in new equity capital within 120 days of the effective date of the order. Article II provided that if the Bank was unable to develop an acceptable program

to raise the $1,500,000 in new equity capital within 120 days of the order's effective date, or was unable to implement such program within 240 days of the effective date, the Board of Directors was required to submit immediately realistic proposals to the Regional Administrator for the sale or merger of the Bank. A comparison of these provisions with the April 17, 1981 amended version of Articles I and II shows that the amendment merely clarified the dates for action. Thus, Article I as amended requires the Bank to submit an acceptable program to the Regional Administrator to raise the $1,500,000 in new equity capital by August 24, 1981. Failure to raise at least $1,500,000 in new equity capital by August 24, 1981 triggers the Article II requirement that the Board of Directors immediately submit realistic proposals to the Regional Administrator for the sale or merger of the Bank.

Pursuant to Article I of the order, the Bank developed a program to raise $1,500,000 in new equity capital through the issuance of additional stock but on May 26, 1981, the shareholders of the Bank voted against the proposed stock offering. Counsel to the Comptroller has moved that Article II be deleted and Article I be modified to require the Bank to offer for sale by August 24, 1981, the $750,000 in equity capital which the shareholders have approved, and by December 31, 1981, to achieve and thereafter maintain a level of equity capital to total assets of at least 8 percent.

Respondents have also moved that Article I be changed to require the Bank to promptly raise $750,000 in new equity capital under existing shareholder approval. Respondents would leave Article II in effect, merely modifying the triggering date to conform with their suggested revision of Article I.

In view of the fact that the Bank's shareholders have already approved the raising of $750,000 in new equity capital, and the continuing need of the Bank to achieve adequate capital as soon as possible and thereafter to maintain capital at an acceptable level, I am modifying Article I and deleting Article II as requested by counsel to the Comptroller.

Respondents' suggested changes in Articles I and II are denied because the proposed implementation will not be achieved by a date certain and because, unlike counsel to the Comptroller's proposal, the respondents' suggested change of Article I does not provide for achievement by December 31, 1981 and maintenance thereafter of adequate capital. See, respondents' proposed order, attached to respondents' motion for modification. Raising an additional $750,000 may or may not be sufficient to assure that the Bank has ade-

quate capital by a specified time, and the counsel to the Comptroller's proposed change of Article I takes account of this fact. I also note that the deletion of Article II alleviates the potential impact of the order on the Bank to some extent. While the Bank directors may still arrange for the sale or merger of the Bank, they are no longer required to do so under the order as it is now being amended. Finally, I deny respondents' request that Articles IV and XV of the order be modified. Article IV covers an outstanding violation of 12 U.S.C. § 371d, a matter fully litigated in these proceedings both administratively and before the United States Court of Appeals for the Second Circuit; the provision remains necessary and appropriate to achieve corrective action. The effective date in Article XV has already been established, remains operative, and accordingly

should not be conditioned upon respondents' consent.

For reasons discussed above, I hereby rule:

(1) Article I of the order as amended April 17, 1981, is further amended as requested by counsel to the Comptroller;

(2) Article II of the order as amended April 17, 1981, is deleted as requested by counsel to the Comptroller;

(3) Respondents' motion requesting modification of the Comptroller's order is denied; and

(4) Respondents' motion requesting oral argument is denied.

The amendment of the order is attached.

/s/ Charles E. Lord
Acting Comptroller of the Currency

Dated: June 29, 1981

UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

IN THE MATTER OF THE FIRST NATIONAL BANK OF SCOTIA, SCOTIA, NEW YORK; KENNETH E. BUHRMASTER; and LOUIS H. BUHRMASTER	Docket No. AA-EC-80-1

A Cease and Desist Order against the First National Bank of Scotia, Scotia, New York, its directors, employees, and agents, collectively; and Kenneth E. Buhrmaster and Louis H. Buhrmaster, individually.

AMENDMENT TO ORDER TO CEASE AND DESIST

WHEREAS, the Comptroller of the Currency ("Comptroller") issued an order to cease and desist against the First National Bank of Scotia, Scotia, New York ("Bank"), Kenneth E. Buhrmaster and Louis H. Buhrmaster on November 24, 1980;

WHEREAS, the order to cease and desist became effective on December 24, 1980;

WHEREAS, Articles I and II of the order to cease and desist were amended by an order of the Comptroller dated April 17, 1981;

WHEREAS, the Comptroller deems it necessary to amend Article I further and to delete Article II;

NOW, THEREFORE, pursuant to the authority vested in him by the Financial Institutions Supervisory Act, as amended, (12 U.S.C. § 1818) and by the terms of the order to cease and desist, the Comptroller hereby deletes Article II and amends Article I of the order to cease and desist to read as follows:

ARTICLE I

(1) The Bank shall achieve and thereafter maintain a level of equity capital to total assets of at least 8 percent by December 31, 1981. In achieving this ratio, the

Bank shall offer for sale the $750,000 in equity capital which the shareholders have authorized. This sale shall be completed by August 24, 1981. Failure to sell the full $750,000 stock issuance shall not relieve the Bank of its obligation pursuant to this paragraph to achieve the 8 percent equity capital to total assets ratio.

IT IS SO ORDERED this 29th day of June, 1981.

/s/ Charles E. Lord
Acting Comptroller of the Currency

ADDENDUM C

UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY

IN THE MATTER OF THE FIRST NATIONAL BANK OF SCOTIA, SCOTIA, NEW YORK; KENNETH E. BUHRMASTER; and LOUIS H. BUHRMASTER	Docket No. AA-EC-80-1

A Cease and Desist Order against the First National Bank of Scotia, Scotia, New York, its directors, employees, and agents, collectively; and Kenneth E. Buhrmaster and Louis H. Buhrmaster, individually.

ORDER TO CEASE AND DESIST

WHEREAS, the First National Bank of Scotia, Scotia, New York (hereinafter "BANK"), Kenneth E. Buhrmaster, and Louis H. Buhrmaster, having appeared at an administrative hearing held before the Honorable John J. Mathias, Administrative Law Judge, which hearing litigated the accuracy and sufficiency of a Notice of Charges issued against the BANK,

Kenneth E. Buhrmaster, and Louis H. Buhrmaster pursuant to 12 U.S.C. § 1818(b) by the Comptroller of the Currency of the United States of America (hereinafter "COMPTROLLER");

WHEREAS, the COMPTROLLER, based on the record of the hearing and the recommended decision, findings of fact and conclusions of law of the Administrative Law Judge, finds that unsafe and unsound banking practices and violations of law, rule and regulation cited in the Notice of Charges have been proven and that these practices and violations warrant the issuance of this Order to Cease and Desist;

NOW, THEREFORE, the COMPTROLLER, acting by virtue of the authority conferred on him by 12 U.S.C. § 1818(b), hereby ORDERS THAT:

ARTICLE I

(1) Within thirty (30) days of the effective date of this ORDER, the BANK shall submit to the Regional Administrator of Na-

tional Banks for the Second National Bank Region, New York, New York (hereinafter "REGIONAL ADMINISTRATOR"), for his approval, a program to raise at least one million five hundred thousand dollars ($1,500,000) in new equity capital within one hundred and twenty (120) days of said effective date. If the REGIONAL ADMINISTRATOR disapproves the program for any reason, the BANK shall promptly amend the program in accordance with the REGIONAL ADMINISTRATOR's comments and shall continue to re-submit it until the REGIONAL ADMINISTRATOR approves it. Upon written notification of the REGIONAL ADMINISTRATOR's approval, the BANK shall promptly implement and strictly adhere to the program.

ARTICLE II

(2) If the BANK is unable to develop an acceptable program to raise $1,500,000 in new equity capital within one hundred and twenty (120) days of the effective date of this OR-

DER, or is unable to implement such a program within two hundred and forty (240) days of the effective date of this ORDER, the Board of Directors of the BANK shall immediately submit realistic proposals to the REGIONAL ADMINISTRATOR for the sale or merger of the BANK.

ARTICLE III

(3) The BANK shall immediately submit to the REGIONAL ADMINISTRATOR for his review the name and background of the BANK's Senior Lending Officer, who shall have primary responsibility for the overall lending functions of the BANK. If the REGIONAL ADMINISTRATOR decides that the individual is not qualified for the position, the BANK shall, within one hundred and twenty (120) days of the effective date of this ORDER, employ a new, capable and experienced Senior Lending Officer whose qualifications have been reviewed by the REGIONAL ADMINISTRATOR. Fail-

ure by the REGIONAL ADMINISTRATOR to exercise power of veto over the current or a new Senior Lending Officer shall not constitute an approval or endorsement of the officer.

ARTICLE IV

(4) Within one hundred and eighty (180) days of the effective date of this ORDER, the BANK, Kenneth E. Buhrmaster and Louis H. Buhrmaster shall correct the outstanding violation of 12 U.S.C. § 371d by:

(a) injecting sufficient equity capital into the BANK to satisfy the provisions of 12 U.S.C. § 371d; or

(b) causing the J.H. Buhrmaster Company to transfer title to the property located at 120 Erie Boulevard, Schenectady, New York, to the BANK for the

purpose of selling said property, under terms and conditions acceptable to the REGIONAL ADMINISTRATOR; or

(c) any other method acceptable to the REGIONAL ADMINISTRATOR.

(5) The BANK shall retain an independent, outside, qualified auditor acceptable to the REGIONAL ADMINISTRATOR to determine the exact amount of the BANK's investment in the Erie Boulevard branch. For the purposes of this Article, the BANK's investment shall be defined to include its original costs for development and leasehold improvements, plus any rental payments determined by the auditor to be in excess of fair market rental for the space occupied by the BANK, less any depreciation of the leasehold improvements determined under generally acceptable accounting

principles.

(6) If, in correcting the violation, the BANK does not recover its full investment in the branch, as determined in Paragraph 5 above, Kenneth E. Buhrmaster and Louis H. Buhrmaster shall indemnify the BANK for the amount of the investment not recovered. The Buhrmasters, however, shall not borrow, either directly or indirectly, from the BANK in order to make any required indemnification.

(7) Effective immediately, the BANK shall cease paying for the following items:

(a) taxes assessed on land owned by the Sanrit Realty Corporation;

(b) easement rights over land owned by the J.H. Buhrmaster

Company or the Sanrit Realty Corporation; and

(c) depreciation expenses taken by the J.H. Buhrmaster Company.

ARTICLE V

(8) The BANK shall not violate the provisions of 12 U.S.C. § 371d in the future.

(9) The BANK shall promptly implement adequate policies and procedures to ensure that it does not violate the provisions of 12 U.S.C. § 371d in the future.

ARTICLE VI

(10) The BANK shall not loan additional money or otherwise extend credit to any borrower whose loan or other extension of credit has been criticized in whole or in part in the Report of Examination, dated April 16, 1979, or in any subsequent Reports of Examination, so long as the credit remains criti-

cized or uncollected.

(11) The preceding paragraph shall not be deemed applicable if failure to take such action by the BANK would be substantially and critically detrimental to its best interests. Before any such action is taken, however, the Board of Directors shall place in the credit file of the borrower a statement, signed by a majority of the directors, detailing why such action is deemed necessary.

ARTICLE VII

(12) The Board of Directors shall ensure that the BANK's Allowance for Possible Loan Losses is maintained at an adequate level in relation to the risk inherent in the BANK's loan portfolio.

(13) The Board of Directors shall conduct quarterly reviews to determine the adequacy of the BANK's Allowance for Possible Loan Losses. These reviews shall be compre-

hensive and shall focus particular attention on the following factors:

(a) loan loss experience; and

(b) an estimate of potential loss exposure on each significant credit.

The Board of Directors' analysis of the Allowance shall be fully supported by a written summation and documentation, as set forth in the April 16, 1979 Report of Examination, as supplemented or modified in the March 17, 1980 Report of Examination. The Board of Directors shall submit the summary of its review to the REGIONAL ADMINISTRATOR no later than 20 days after the end of each quarter.

(14) If, after his review, the REGIONAL ADMINISTRATOR determines that the Allowance is inadequate in relation to the risk

inherent in the BANK's loan portfolio, the Board of Directors shall immediately make additional provisions.

ARTICLE VIII

(15) Within sixty (60) days of the effective date of this ORDER, the BANK shall develop and implement a plan to correct the internal control exceptions noted in the April 16, 1979 Report of Examination, as supplemented or modified in the March 17, 1980 Report of Examination.

(16) Within ninety (90) days, the Board of Directors shall employ a full-time internal auditor who shall be solely responsible to the Board of Directors. Also, within one hundred twenty (120) days, the Board of Directors, with the assistance of the new internal auditor, shall formulate comprehensive plans for an internal audit program acceptable to the REGIONAL ADMINISTRATOR.

(17) The BANK shall have a comprehen-

sive external audit of the BANK performed on an annual basis.

ARTICLE IX

(18) Within thirty (30) days of the effective date of this ORDER, the Board of Directors shall submit an acceptable written asset and liability management program to the REGIONAL ADMINISTRATOR for his approval to reduce the BANK's reliance upon rate sensitive deposits and borrowed funds.

ARTICLE X

(19) The BANK shall not declare or pay any dividend except:

(a) in conformity with 12 U.S.C. § 60;

(b) when justified by sound banking policies; and

(c) with the prior written approval of the REGIONAL ADMINISTRATOR.

(20) Within sixty (60) days of the effective date of this ORDER, the Board shall formulate a written program, acceptable to the REGIONAL ADMINISTRATOR, to restore and satisfactorily maintain the earnings of the BANK. Such program shall include a detailed monthly budget for 1981 and 1982 and shall include, but not be limited to, the following specific terms:

(a) measures to increase net interest earnings; and

(b) measures to reduce occupancy and personnel expenses.

(21) The budget shall detail all proposed balance sheet and income and expense items for the year 1981 and 1982. In addition, the BANK shall forward to the REGIONAL ADMINISTRATOR, at the end of each month, a balance sheet and profit and loss statement

for the month and year to date, with comparative figures for the same period in the preceding year as well as for the budgeted amounts for 1979.

(22) The BANK shall not increase any salaries, expenses, or fees for its present executive officers and directors without the prior written approval of the REGIONAL ADMINISTRATOR.

ARTICLE XII

(23) Within thirty (30) days of the effective date of this ORDER, and on a monthly basis thereafter, the BANK shall provide the REGIONAL ADMINISTRATOR with the following progress reports:

(a) past due loan summaries;

(b) status reports on all criticized assets; and

(c) reconcilements on the Allowance for Possible Loan Losses.

ARTICLE XIII

(24) The BANK shall promptly implement adequate policies and procedures to ensure that in the future it does not violate the provisions of:

(a) 12 C.F.R. § 1.8;

(b) 12 C.F.R. § 7.3025; and

(c) 31 C.F.R. § 103.33(a).

ARTICLE XIV

(25) The Board of Directors of the BANK shall promptly appoint a Compliance Committee composed of three directors who are not officers of the BANK. This Committee shall have the responsibility of ensuring compliance by the BANK with the provisions of this ORDER. Within thirty (30) days of the effective date of this ORDER, and on a monthly basis thereafter, the Committee shall submit to the REGIONAL ADMINISTRATOR detailed progress reports setting forth the actions

taken by the BANK to comply with the provisions of this ORDER and the results of those actions.

ARTICLE XV

(26) The provisions of this ORDER shall become effective thirty (30) days after service of this ORDER by the COMPTROLLER, and shall remain effective and enforceable, except to the extent that, and until such time as, any provisions of this ORDER shall have been amended, suspended, waived, or terminated by the COMPTROLLER.

It is so ORDERED this 20th day of November, 1980.

/s/ Lewis G. Odom, Jr.
Lewis G. Odom, Jr.
by designation
Acting Comptroller of the
Currency

ADDENDUM D

JOINT NEWS RELEASE

COMPTROLLER OF THE CURRENCY
FEDERAL RESERVE BOARD

For immediate release December 17, 1981

The Comptroller of the Currency and the Federal Reserve Board today announced that they are issuing to the financial institutions they supervise guidelines to be used in assessing the adequacy of their capital.

The capital adequacy guidelines -- which are attached -- will be used by the two agencies in their examination and supervision of national banks, state chartered banks that are members of the Federal Reserve System and bank holding companies.

The agencies developed the guidelines in the interest of achieving greater consistency in their supervisory activities. The guide-

lines should also be helpful to banking organizations in their financial planning. The regulators stressed that the guidelines will be used in a manner that allows for consideration of differences in the situations of individual financial institutions.

One of the objectives of the agencies was to address the sizable existing disparity in capital ratios among banking organizations of different size. To this end, the agencies considered both qualitative characteristics and practical economic and market constraints which often account for differences in capital ratios. The program adopted will permit somewhat lower capital ratios for smaller banks than most of these institutions currently maintain. At the same time, the agencies indicated that their policies with respect to the multinational banking organizations -- at present, 17 institutions with assets in excess of $15 billion -- would be

amended to insure that appropriate steps are taken to improve over time the capital positions of banking organizations in this group.

The guidelines will be reviewed from time to time for possible adjustment commensurate with changes in the economy, financial markets and banking practices. As conditions permit, further consideration will be given to the differences in the capital ratios by size of institution.

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Attachment

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
OFFICE OF THE COMPTROLLER OF THE CURRENCY

CAPITAL ADEQUACY GUIDELINES

The Federal Reserve and the Office of the Comptroller of the Currency have developed capital adequacy guidelines to provide a framework for assessing the capital of well-managed national banks, state member banks and bank holding companies.[1/] The guidelines will be used in the examination and supervisory process and will be reviewed from time to time for possible adjustment commensurate with changes in the economy, financial markets and banking practices.

Objectives of the capital adequacy guidelines program are to:

1/ Institutions that are under special supervision and those that have been in operation for less than two years are not included in the program.

- address the long-term decline in capital ratios, particularly those of the multinational group;

- introduce greater uniformity, objectivity and consistency into the supervisory approach for assessing capital adequacy;

- provide direction for capital and strategic planning to banks and bank holding companies and for the appraisal of this planning by the agencies; and,

- permit some reduction of existing disparities in capital ratios between banking organizations of different size.

Two principal ratio measurements of capital will be used: (1) primary capital to total assets; and (2) total capital to total assets. Primary capital consists of common stock, perpetual preferred stock, capital surplus, undivided profits, reserves for contingencies and other capital reserves, mandatory convertible instruments and the allowance for possible loan losses. Total capital includes the primary capital components plus

limited life preferred stock and qualifying subordinated notes and debentures.

The capital guidelines generally will be applied on a consolidated basis. However, for those bank holding companies with consolidated assets under $150 million, the capital guidelines will apply to the bank only, if: (1) the company does not engage directly or indirectly in any nonbanking activity involving significant leverage; and (2) no significant debt of the parent company is held by the general public.

Some bank holding companies are engaged in significant nonbanking activities that require capital ratios higher than those for the bank alone. In these cases, appropriate adjustments will be made in the application of the consolidated capital guidelines.

Institutions affected by the guidelines are categorized as either multinational organizations (as designated by their respec-

tive supervisory agency); regional organizations (all other institutions with assets in excess of $1 billion)[1/]; or community organizations (less than $1 billion in total assets).

Capital guidelines for the relatively small number of multinational organizations will continue to be formulated and monitored on an individual basis, taking into account their present and prospective financial condition. The supervisory agencies are increasingly concerned about the secular declines in the capital ratios of the nation's largest banking organizations, particularly in view of increased risks both domestically and internationally. In general, supervisory policies of the Federal Reserve and the Office of the Comptroller of the Currency, designed to arrest the secular decline in the

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1/ May include some institutions located in money centers.

capital ratios of this group of institutions, will be modified to insure that appropriate steps are taken to improve over time the capital positions of this group.

A mimimum level of primary capital to total assets is established at 5 percent for regional organizations and 6 percent for community organizations. Generally, regional and community banking organizations are expected to operate above the minimum primary capital levels.

The agencies also have established capital guidelines for regional and community organizations for the total capital to total assets ratio. These guidelines consist of three broad zones:

	Regional	Community
Zone 1	Above 6.5%	Above 7.0%
Zone 2	5.5% to 6.5%	6.0% to 7.0%
Zone 3	Below 5.5%	Below 6.0%

Generally, the nature and intensity of supervisory action will be determined by the zone in which an institution falls.

For banking institutions operating in zone 1, the agencies will:

- Presume adequate capital if the primary capital ratio is acceptable to the regulator and is above the minimum level;
- intensify analysis and action when unwarranted declines in capital ratios occur.

For banking institutions operating in zone 2, agencies will:

- presume that the institution may be undercapitalized, particulary if the primary and total capital ratios are at or near the minimum guidelines;
- engage in extensive contact and discussion with the management and require the submission of comprehensive capital plans acceptable to the regulator;
- closely monitor the capital position over time.

The agencies' approach to institutions operating in zone 3 will include:

- a very strong presumption that the bank is undercapitalized;

- frequent contact with management and a requirement that the bak submit a comprehensive capital plan, including a capital augmentation program that is acceptable to the regulator;

- continuous analysis, monitoring and supervision.

The guidelines will be applied in a flexible manner with exceptions as appropriate. The assessment of capital adequacy will continue to be made on a case-by-case basis considering various qualitative factors that affect an institution's overall financial condition. Thus, the agencies retain the flexibility to recognize the unique characteristics of sound and well-managed banks.

ADDENDUM E

Comptroller of the Currency
Administrator of National Banks

Second National Bank Region
1211 Avenue of the Americas, Suite 4250
New York, New York 10036
212-944-3495 (Regional Administrator of National Banks)

December 10, 1981

Mr. K. E. Buhrmaster
Chairman of the Board
First National Bank of Scotia
201 Mohawk Avenue
Scotia, New York 12302

Dear Mr. Buhrmaster:

We are enclosing a Certificate of Approval, effective October 21, 1981, increasing the Bank's common stock from $1,593,750.00 to $1,863,880.00, by the sale of shares having an aggregate par value of $270,130.00 and a total sale price of $540,260.00.

Giving consideration to this capital injection, our analysis reveals that the Bank's equity capital to total assets is 6.2%.

The management is reminded that an equity capital to total asset ratio of 8% must be reached by December 31, 1981 to attain compliance with Article I of the Cease and Desist Order.

Very truly yours,

JOHN A. BODNAR
Deputy Regional Administrator for
Examinations

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

Charter No. 14680

CERTIFICATE OF APPROVAL

Whereas notice has been transmitted to the Comptroller of the Currency certifying that requisite legal action has been taken by FIRST NATIONAL BANK OF SCOTIA located in SCOTIA State of NEW YORK in compliance with Title 12 U.S.C., Section 57 to increase the common stock of that association to $1,863,880.00 by the issuance of $270,130.00 par value of such stock, therefore, it is hereby certified that such increase in common stock is approved effective OCTOBER 21, 1981.

/s/ Charles E. Lord
Acting Comptroller of
the Currency

ADDENDUM F

1ST
NATIONAL
BANK OF
SCOTIA

October 30, 1981

Mr. Thomas W. Taylor
Regional Administrator of National Banks
Second National Bank Region
1211 Avenue of the Americas, Suite 4250
New York, New York 10036

Dear Mr. Taylor: Re: $750,000 stock sale

We have sold all the stock we can sell. We have contacted shareholders, depositors, borrowers, friends, relatives, community leaders, and have advertised in newspapers. It is now clear that we will not achieve an 8% capital ratio by year-end 1981, unless we reduce our deposits and assets by enough to bring us to the 8% ratio with our existing capital. It is also clear that such a reduction would severely damage the bank.

To comply with the Comptroller's order, we have reduced from over $22 million to about $3 million our rate-sensitive deposits of over $100,000. This reduction in deposits was matched with a reduction in the older, and lower yielding, installment loans in the bank's portfolio. The bank, however, now has no more low yielding assets which can be sold or reduced to match a loss of deposits. A further runoff in rate-sensitive or other deposits would instead require the bank to dispose of high yielding assets, which now constitute the principal source of the bank's earnings.

Other banks of our peer group, who respond to the same competitive and economic forces as First National Bank of Scotia, but who have not been ordered either to reduce rate-sensitive deposits or to achieve a specific capital-to-assets ratio, have increased their rate-sensitive deposits, as shown on the next page. Our own experience is that funds generated by rate-sensitive deposits can be reinvested at a spread of 1% to 2%. The peer group growth rate for such deposits, as shown in the chart, would indicate that other banks also are able profitably to reinvest their rate-sensitive deposits.

Rate Sensitive CD's as a % of Average Assets

Date	FNB	Peer Group
12-30-76	19.18%	8.67%
12-30-77	20.64%	8.28%
12-30-78	21.01%	9.27%
12-30-79	19.15%	16.03%
12-30-80	16.22%	24.09%
06-30-81	15.27%	28.60%

We believe that, to regain its profitability, First National Bank of Scotia must be permitted, as are other banks, to continue--and perhaps even expand--its well-controlled program of matched rate-sensitive deposits and assets. Since no portion of the bank's earnings may be paid out as dividends without your prior approval, the earnings thus generated also are the key element in building the bank's capital.

Forcing a deposit and asset runoff to achieve a year-end 8% capital-to-asset ratio,

however, would have just the opposite effect. Our estimates are as follows:

	Assets	Projected Stock Sale	Estimated* Equity Capital	Est. % of Capital/Assets
Sept. 30	45,000	500	3,170	7.04%
October	44,000	50	3,200	7.27%
November	43,000	-	3,200	7.44%
December	40,000	-	3,200	8.00%

* 60% of capital debentures; 100% of Res. for Bad Debt, U.P., surplus and common stock.

Thus, a reduction in deposits of $5 million would cost the bank a potential $100,000 in earnings next year. Such a program of asset reduction would actually prevent the bank from producing the earnings necessary to increase its capital base.

We therefore plan not to shrink any further the bank's deposits and assets, but instead to achieve the 8% capital ratio as soon as possible through retained earnings. Please advise us if you disagree.

Sincerely yours,

K. E. Buhrmaster
Chairman of the Board

L. H. Buhrmaster
President

KEB/LHB:cg

cc: Comptroller of the Currency
Special Projects Group

ADDENDUM G

Comptroller of the Currency
Administrator of National Banks

Second National Bank Region
1211 Avenue of the Americas, Suite 4250
New York, New York 10036
212-944-3495 (Regional Administrator of National Banks)

November 17, 1981

Mr. K. E. Buhrmaster
Chairman of the Board
First National Bank of Scotia
201 Mohawk Avenue
Scotia, New York 12302

Dear Mr. Buhrmaster:

We have reviewed your letter dated October 30, 1981 in which you indicate that you do not plan to shrink the bank's deposits and assets any further, but instead plan to achieve the 8% capital ratio as soon as possible through retained earnings.

As I'm sure you are aware, Article I of the Cease and Desist Order as amended June 29, 1981 does not specify the manner in which the bank must achieve the 8% maintenance ratio, it does however, require that the ratio be achieved by December 31, 1981. Accordingly,

your plan to achieve this ratio as soon as possible is not in accordance with the Order.

Very truly yours,

THOMAS W. TAYLOR
Regional Administrator

ADDENDUM H

1ST
NATIONAL
BANK OF
SCOTIA

March 18, 1982

Mr. C. T. Conover
Comptroller of the Currency
490 L'Enfant Plaza
Washington, D.C. 20219

Dear Mr. Conover:

Under the Cease & Desist Order issued by your office on December 24, 1980, our bank was required to first raise $1,500,000 in equity capital by August 24, 1981. This Order was amended on June 29, 1981, requiring the raising of $750,000 in new capital, and to maintain an 8% capital-to-assets ratio as of December 31, 1981. Both Orders were upheld by the U.S. Court of Appeals for the Second Circuit Court.

As of March 11, 1982, our capital ratio was 7.09%; this ratio was calculated in accordance with the capital guidelines issued by your office on December 17, 1981, as follows:

Net Assets (3-11-82)	Equity Capital	
$45,123,663	Capital	$1,865,490
	Surplus	1,865,490
	60% of subordinated debentures	150,000
	Res. for Loan Loss	196,091
	Undivided Profits	(876,223)
$45,123,663		$3,200,848

We raised last fall $543,480 in equity capital, and have exhausted our sources of funds in this area. We used personal contact, direct mail, and newspaper advertising. We extended the stock sale for an additional 90 days, through December 31, 1981. During this time period, we raised only an additional $3,220 in capital, and our expenses were $2,468. It would not be cost effective to ask for an additional extension of the sale.

On February 2, 1982, your office, for the first time, suggested in a brief to the Court of Appeals that the 8% capital ratio requirement might be met by selling shares at a price lower than the $20 per share of the 1981 stock offering. This suggestion, frankly, surprises us, since the $20 per share price had been approved by your Regional Office on April 29, 1981 under Article I of the Cease & Desist Order, and also had been approved in the modified Order of July 29, 1981 which directed the sale of stock thorugh the offering, "which the shareholders had authorized", i.e. an offering of 37,500 shares at $20 per share. At no time prior to February 23, 1982 had anyone from the Comptroller's office even orally suggest that the bank should be issuing any securities other than common stock at $20 per share.

We do not think that selling more stock will be successful, simply because all those that bought stock realized that there wouldn't be a dividend for a long time, and even when dividends return they will not be anywhere near market rates. Those that bought stock were supporting the bank in raw dollars, not in anything else. They would have invested the same number of dollars whether the price was $10 per share or $20 per share. To now sell at less than $20 per share would

be unfair to those who came forward in our time of need. Moreover, selling common shares at a price lower than twice the $10 per share value of all the now outstanding common stock would have adverse consequences on the bank's capital and surplus accounts, which already are adversly impacted by a deficiency of -$876,223 in the Undivided Profits account. Before considering such a sale, the bank would need the advice of your office as to how its capital accounts should be restructured.

Another alternative would be to issue a convertible preferred stock, paying close to a market rate of interest. We have never used a preferred stock, and we would need to have explicit guidance from your office on how to price such an offering.

As of March 11, 1982, our assets were $45,123,663, and to achieve an 8% capital ratio we would need $409,045 in new capital. Although we can proceed with either of the above alternatives, upon your direction, we believe that almost all of any available funds for the support of our bank have been used at this time.

The only other solution, as suggested by Mr. R. Pasley of your Enforcement and Compliance Division, is to sell assets and shrink the bank. As of March 11, 1982, we would have to sell $5,113,663 in assets without a loss, to achieve the 8% ratio. In the following table we have taken groups of highest-return and lowest-return assets and priced them to see what our losses would be if we were to choose this alternative:

Profit/Loss Analysis on Sale of $5,113,000 in Assets

		LOSS
1.	Sale of Lowest-Yield Mortgages:	2,578,286
2.	Sale of Highest-Yield Mortgages:	1,507,094
3.	Sale of Lowest-Yield Corporate Securities:	1,323,000
4.	Sale of all Municipal Securities and Lowest-Yield U.S. Treasury Securities:	1,487,597
5.	Sale of Highest-Yield Corporate Securities:	1,036,180
6.	Sale of all U.S. Treasuries and Highest-Yield Municipal Securities:	974,877
7.	Sale of Highest-Yield Corporate, Municipal, U.S. Government Securities and Mortgages:	504,914

As you can see, the loss on the sale of assets with the lowest rate of return would ruin the bank. Even the sales of assets having the highest rates of return would cause a substantial loss. The fallacy in selling assets at a loss is that every time you take a loss, you reduce capital and the capital ratio, and thereby require the sale of even more assets. However, we have been ordered to achieve the 8% ratio. We do not believe that shrinking the bank is what you want us to do; we would appreciate your guidance.

Corresponding with the sale of assets, we would have to reduce our liabilities. We have seven excellent customers with deposits of over $100,000 each, totaling $1,600,000. As stated before in our correspondence with your office, we used to have over $22,000,000 in so-called rate-sensitive deposits early in 1978 at a time when our assets exceeded $70,000,000. Almost all of our remaining customers who hold money-market type certificates of our bank are our best, full-service customers. Once we deny them competitive rates on so-called rate-sensitive deposits, we will also lose their other profitable deposits.

As stated in the January 20, 1982 letter from the Regional Office, (Exhibit A) which was in response to our letters of December 17, 1981 and October 30, 1981 (Exhibit B and Exhibit C), expansion of rate-sensitive assets is needed to return the bank to profitability. Money is our raw material, and without it, profits are not possible.

We are at a loss as to what action to take in regard to 371(d). Both the bank and the J.H. Buhrmaster Co., Inc. want to see the Erie Boulevard building sold, and this has been so since November 1, 1979 when the J.H. Buhrmaster Co., Inc. started trying to sell the building to the General Electric Company. The property is listed with the most successful real estate broker in the Capital District, and is being widely advertised. The bank is suing to obtain title to the land and building, and the J.H. Buhrmaster Co., Inc. is counter-suing. We have no way of knowing when or how this matter will be resolved.

We believe that we have explored all possible means of compliance with the Cease &

Desist Order in this letter, and we solicit your direction and guidance at this time.

Sincerely yours,

THE BOARD OF DIRECTORS
First National Bank of Scotia

K. E. Buhrmaster
Chairman

L. H. Buhrmaster
President

Joseph E. Martinec
Director

David D. Montana
Director

Fredric K. Lindsay
Vice President

David L. Schweizer
Director

Thomas S. Kramlick
Director

BOD;cg
Enc.

cc: Thomas W. Taylor
Regional Administrator

ADDENDUM I

1st
NATIONAL
BANK OF
SCOTIA

May 14, 1982

Mr. William L. Robertson
Deputy Comptroller for Special
Surveillance
Comptroller of the Currency
490 L'Enfant Plaza
Washington, D.C. 20219

Dear Mr. Robertson:

In response to your letter of April 14, 1982 and in accordance with the time extension to May 14, 1982 granted by your counsel Robert Pasley on April 23, 1982, the following is submitted on behalf of both the First National Bank of Scotia and of each of its directors. Each director also is writing separately on his own behalf.

The statement in your letter that you are considering assessing civil penalties against the bank is startling. As explained in our numerous litigation filings and recent correspondence with the Comptroller, the bank and its Board of Directors have done everything within their power to comply with the November 20, 1980 Cease & Desist Order modified on June 29, 1981. The Comptroller's own examination reports demonstrate that the bank has complied with all of the Order's extensive provisions, except for the 8% capital requirement. As to that requirement, the bank has written both the Regional Adminis-

trator and the Comptroller about its potential harm to the bank, and has sought the guidance of your office about whether and how to comply (see, e.g., letters of March 18, 1982 and April 1, 1982 (with enclosures), Exhibits II and JJ hereto). We were expecting to receive that guidance rather than your letter of April 20, 1982.

The bank's record of compliance and the following review of the factors recited in your letter establish that no penalties should be assessed against the bank or its directors.

(a) Factors involving the financial resources of the bank.

The Comptroller should be well aware of the bank's financial resources. The losses that the bank has sustained since 1978 are as follows:

1978:	$ 93,868.47	
1979:	491,476.32	
1980:	318,917.62	
1981:	270,440.43	
1982:	4,762.98	(through 3-31)

As of March 31, 1982, the bank has an impaired surplus of $975,520.38. Any civil penalties assessed against the bank would further deplete the bank's capital and delay the bank's return to profitability.

(b) Any good faith effort surrounding the alleged violations.

Article I of the Order:

The bank's actions prior to April 8, 1980 in regard to the capital requirements of

Article I of the Order are included in the administrative record within your possession. Subsequent to the administrative proceedings, the bank has undertaken, in good faith, considerable efforts to achieve the 8% equity capital to total assets ratio that the June 29, 1981 modification to the Order required as of December 31, 1981. The following exhibits (copies attached) exemplify the bank's efforts in this regard:

EXHIBIT	DATE	DESCRIPTION
A	01-20-81	K. E. Buhrmaster, Chm. to T. W. Taylor, R.A.
B	01-27-81	L. H. Buhrmaster, Pres. to J. Bodnar, Dep. R.A.
C	02-03-81	J. Bodnar, DRA, to L. H. Buhrmaster, President
D	02-25-81	L. H. Buhrmaster, President to T.W. Taylor, R.A.
E	03-13-81	T. W. Taylor, R.A. to Board of Directors
F	03-27-81	L. H. Buhrmaster, Pres. to T. W. Taylor, R.A.
G	03-27-81	K. E. Buhrmaster, Chm. to T. W. Taylor, R.A.
H	04-17-81	C. Lord, Acting Compt. to Board of Directors
I	04-21-81	K. E. Buhrmaster, Chm. to T. W. Taylor, R.A.
J	04-29-81	J. A. Bodnar, DRA, to Board of Directors
K	05-01-81	Letter to Shareholders
L	05-01-81	K. E. Buhrmaster, Chm. to J. Bodnar, Dep. R.A.
M	05-19-81	Prospect List
N	05-19-81	Plan to set up CD's
O	05-11-81	T. W. Taylor, R.A. to K. E. Buhrmaster, Chm.

P	05-26-81	K. E. Buhrmaster, Chm. to T. W. Taylor, R.A.
Q	05-27-81	K. E. Buhrmaster, Chm. to T. W. Taylor, R.A.
R	06-05-81	L. H. Buhrmaster, Pres. to Officers, Directors, MT's
S	06-05-81	L. H. Buhrmaster, President, to Shareholders
T	06-18-81	J. C. VanWormer, V.P. to W. Herrick, S.D.D.
U	08-17-81	F. K. Lindsay, V.P. to Officers, Directors, MT's
V	08-27-81	L. H. Buhrmaster, Pres. to Officers, Directors, MT's
W	08-20-81	L. H. Buhrmaster, President, to Shareholders
X	08-19-81	Statement stuffer used 8-31, 9-30 and 11-30-81
Y	09-21-81	L. H. Buhrmaster, President, to Shareholders
Z	09-28-81	D. E. Brothers, Auditor, to Officers, Directors, MT's
AA	10-05-81	K. E. Buhrmaster, Chm. & L. H. Buhrmaster, Pres., to Officers
BB	10-15-81	L. H. Buhrmaster, Pres. to All Officers, MT's
CC	10-21-81	K. E. Buhrmaster, Chm. to T. W. Taylor, R.A.
DD	10-30-81	L. H. Buhrmaster, President, 8% Capital Plan
EE	11-05-81	L. H. Buhrmaster, Pres. to Board of Directors
FF	11-16-81	K. E. Buhrmaster, Chm. to Board of Directors
GG	12-09-81	Copy of newspaper ad placed in Capital District newspapers during month of December, 1981

HH	12-09-81	L. H. Buhrmaster, Pres. to All Officers, MT's
II	03-18-82	Board of Directors to C. T. Conover, Comptroller
JJ	04-01-82	Board of Directors to T. W. Taylor, R.A.

The bank, its officers, directors and employees, have spent thousands of hours including nights and weekends, trying to raise equity capital. Officers, directors and others closely associated with the bank on May 18, 1981 deposited a total of $430,000 to help assure the success of any capital offering. Since this deposit was subordinated to the claims of other depositors, almost one-half million dollars in capital-like protection was voluntarily established for the bank's depositors well before any deadline was imposed by the Comptroller's office.

The bank's efforts to raise capital were hampered by delays caused by the Comptroller's Securities Disclosure Division. The bank's approved time table for its stock offering allowed one month for the Comptroller's office to review, respond to, and clear the Offering Circular, even though the bank had been assured that the office intended to clear the circular much more quickly. Contrary to these assurances, clearance of the Offering Circular took two months.

On June 18, 1981, we sent by Express Mail to Mr. W. Michael Herrick of your Securities Division six copies of our proposed Offering Circular. The first contact with any of our officers regarding the circular was made on July 16, 1981, by Mr. Jack Radov of the Securities Disclosure Division. We understand that the Securities Division was

in contact with both Mr. C. Westbrook Murphy and Mr. William Appleton of the Baker and Hostetler firm regarding proposed revisions during the week previous to July 16, 1981.

On July 23, 1981, six copies of the revised draft of the Offering Circular were delivered to your office by the Washington office of Baker & Hostetler. The first written reply to our June 18, 1981 Offering Circular was received by our Vice President, Mr. John C. Van Wormer, on July 28, 1981 in an undated envelope containing an undated letter signed by Mr. Robert M. Kurucza, Director of the Securities Disclosure Division, with nine pages of comments, most of which had already been discussed with and been taken care of by our attorney, Mr. Appleton, in the draft that was delivered on July 23, 1981.

The Offering Circular was not finally declared effective until August 20, 1981 -- just four days before the August 24, 1981 deadline in the Comptroller's Order for completing the stock sale. Since existing shareholders were given 30 days to exercise their preemptive pro rata purchase rights, the delays caused by the Securities Disclosure Division prevented compliance with Article I of the Order.

The offering finally approved on August 20 was for 37,500 shares at $20 per share -- a total of $750,000. At the end of the 30-day preemptive offering to bank shareholders and an additional 30-day offering period to the public, $640,740 remained unsold. Shares totaling $430,000 then were sold to those who in May, 1981 had placed funds for that purpose in a subordinated certificate of deposit. The bank's capital was increased by

$540,260, effective October 21, 1981. An extension of the offering period until December 31, 1981 resulted in the sale of only an additional $3,200 of stock, while the bank's expenses for this extended offering were $2,468.

It would not be cost-effective for the bank to ask for an additional extension of the sale. The bank's officers, directors and employees used personal contact, direct mail and newspaper advertising to solicit buyers for its shares. The bank has simply exhausted its sources of funds to sell more shares.

The bank has carefully considered the other alternative to achieve the 8% equity capital ratio -- which would be for the bank to sell its assets. The bank already has shrunk its total assets from a peak of over $70 million in early 1978 to their present $45 million. As of March 11, 1982, the bank would have to sell another $5,113,663 in assets -- all at book value -- to achieve the 8% capital ratio (Exhibit II).

In its letter of March 18, 1982 to Mr. C. T. Conover, Comptroller of the Currency (Exhibit II), the bank listed its various groups of assets and the respective losses incurred if the assets were sold. As stated in this letter, the loss incurred from a sale of assets with the lowest rate of return would ruin the bank. Even a sale of assets having the highest rates of return would cause a substantial loss. Selling assets at a loss is not desirable for the bank, because if the assets are sold at a loss, the bank's capital would be reduced and the capital ratio lowered. The bank believes that the Comptroller's own Regional Administrator agrees with this conclusion.

In a brief filed with the Court of Appeals on February 22, 1982, the Comptroller's office for the first time suggested that the bank's stock might have been offered at a price other than the $20 per share ($10 par value) at which it was sold and at which all of the bank's outstanding common stock has been issued. This suggestion -- besides being one that would have brought no more actual dollars to the bank -- was and is inconsistent with all of the Comptroller's prior correspondence about, and approvals of, the 37,500 shares offered by the bank at $20 per share.

Other provisions of the order:

The Comptroller's November, 1981 examinaation report acknowledged: "The bank is in compliance with all articles of the Cease and Desist Order . . . except Articles I and IV." Article I already has been discussed. The bank also has complied with Article IV to the fullest extent permitted by law.

Article IV(4)(b) required the bank to cause "the J.H. Buhrmaster Co., Inc. to transfer title to the property located at 120 Erie Boulevard, Schenectady, New York, to the bank . . . ." According to the November 1981 report of examination:

> [T]he bank has made various attempts to sell the unprofitable Erie Boulevard branch building. However, efforts to sell the branch office has been hampered by litigation between the bank and J.H. Buhrmaster Co., Inc. regarding transfer of title of the building from J.H. Buhrmaster Co., Inc. to

the bank. The Compliance Committee has engaged its own counsel and has filed suit against J.H. Buhrmaster Co., Inc., to obtain title to the Erie Boulevard branch in order to comply with the provisions of Article IV of the Order. The suit is still in the courts. The committee has also retained the accounting firm of T. M. Byxbee & Co. to determine the exact amount of the bank's investment in the Erie Boulevard branch as required by Article IV.

The litigation hampering this sale has been caused by the Comptroller's refusal to permit the bank to pay, or even negotiate over, payments contractually due the J.H. Buhrmaster Company. On June 16, 1981, the bank requested that the J.H. Buhrmaster Co., Inc., under the terms of Article III, section 3.3(a) of the April 11, 1974 Agreement (Exhibit KK), transfer title of the property to the bank. On June 17, 1981, the J.H. Buhrmaster Co., Inc. denied the bank's request because of the monies owed by the bank to the company (Exhibit LL). On June 18, 1981, the bank sued the J.H. Buhrmaster Co., Inc. in the New York Supreme Court to require conveyance of the title of the property to the bank (Exhibit MM). On July 8, 1981, the J. H. Buhrmaster Co., Inc. filed an answer (Exhibit NN), and on November 13, 1981 an amended answer and a counterclaim. The suit is still pending in the New York Supreme Court.

As the most recent examination report indicates, the Compliance Committee through its own counsel is acting for the bank in this litigation. Louis and Kenneth

Buhrmaster have recused themselves from any participation on behalf of either the bank or the J.H. Buhrmaster Co., Inc. In this dispute over ownership of the Erie Boulevard property, Kenneth and Louis Buhrmaster, of course, could not use their position as large shareholders of the J.H. Buhrmaster Co., Inc. to urge or approve an action not in the best interest of that corporation or detrimental to its minority shareholders. See, e.g., Superintendent of Insurance v. Bankers Life and Casualty Co., 404 U.S. 6, 13 (1971).

As your records amply document, the Comptroller has refused to modify the Order so as to make possible a non-litigated resolution of the dispute between the bank and the J.H. Buhrmaster Co., Inc. But, notwithstanding this dispute, the bank and Kenneth and Louis Buhrmaster have continued their efforts to find a buyer for the Erie Boulevard property (Exhibits OO and PP). The property has been listed with the most successful real estate broker in the Capital District and has been widely advertised. The Capital District's real estate market has been highly depressed, and together with the dispute over ownership, has impeded the sale of the property.

(c) The gravity of the violations.

The violation of Article I of the order does not warrant concern when the equity capital to total assets ratio of the bank is no different than that of other similarly situated banks. As of March 11, 1982, the bank's total assets to equity capital ratio was 7.09%. This ratio was calculated in accordance with the capital guidelines issued by

the Comptroller's office on December 17, 1981 (Exhibit II).

This 7.09% ratio approximates the ratio of the bank's peer group average which was 7.62%. Moreover, this ratio exceeds the 7% ratio which the Comptroller's capital guidelines state is adequate for community banks (banks with less than $1 billion in assets).

Consideration should also be given to the fact that the bank more truly resembles a savings bank. The percentage of fixed-rate mortgages in the bank's loan portfolio is 43.7%, which is higher than that of the typical savings bank. As we understand, savings banks are not considered to be in serious trouble until their equity capital to total assets ratio falls to 2%.

Nonetheless, the bank and its directors have undertaken good faith efforts to achieve the 8% ratio required by the Order, and we desire to increase the bank's capital. However, as discussed above, the only possible means to increase capital at this time is through earnings. A grave threat to the bank would result from attempting to achieve the 8% ratio through the sale of assets. The Comptroller's office has been totally unresponsive to our repeated requests for advice as to how to achieve the 8% requirement without harming the bank financially.

With regard to Article IV, the bank is in compliance with 12 U.S.C. § 371(d) as interpreted by the Supreme Court in Frank Lyon Co. v. United States, 435 U.S. 561 (1978). The Comptroller was able to find a violation of that statute only because enforcement counsel failed to call his attention to this dispositive Supreme Court opinion. Moreover,

as already noted, the bank and its directors have fully complied with Article IV of the Order.

(d) Any history of previous violations.

The bank has had no history of violations in regard to capital requirements or 12 U.S.C. § 371(d).

(e) Such other matters as you believe justice may require.

Justice requires that consideration be given to the extremely difficult position that the bank has been placed in by the terms of the Order. The bank has persistently sought compliance with the Order, only to be frustrated by the ardous requirements of raising additional capital. The bank also continues to attempt to sell the Erie property, even though such a sale is not expressly required by the Cease & Desist Order. The bank, in litigation and correspondence with the Comptroller, has repeatedly stated that these terms of the Order are overly restrictive and unworkable. Justice therefore requires that recognition be given to the bank's sincere compliance efforts and the impossibility of raising additional capital and an immediate sale of the Erie property.

Justice also requires that civil penalties should not be assessed for any period before the Comptroller's Order was upheld by the Court of Appeals on March 11, 1982, or before Supreme Court review is sought, is denied, or completed. Apparently, the Comptroller agrees that the bank should not be penalized for the period during which it was

seeking judicial review, since your letter concerning penalties was not sent until after the Court had acted. In the absence of a demonstrated threat of such penalties, of course, the bank had no reason to seek a stay of the Comptroller's Order from the Court of Appeals. Cf. Sampson v. Murray, 415 U.S. 61 (1974).

Finally, the bank and directors believe that justice requires the Comptroller to consider compliance with all but Article I of the Order and the improvements in the bank's operations as reported in the most recent examination. These include:

> Improvement has been noted in the reduced volume of criticized assets, reduced reliance on rate sensitive deposits and in the liquidity and funds management areas.
>
> * * * *
>
> Management's considerable efforts to improve earnings have resulted in a decrease both in the level of operating losses and in the level of loan losses.
>
> * * * *
>
> As noted above, the level of criticized assets continues to decline. This decline is primarily attributable to management's concerted efforts to clear up problem loans. Another area of notable improvement is the decrease in assets classified loss.
>
> * * * *

The quality and capacity of active management has shown improvement, particularly in the lending area.

* * * *

The bank's funds and liquidity management practices and procedures are also improved. As of the examination date, the bank was in a slightly liability sensitive position. The reliance on rate sensitive deposits has declined substantially. Acceptable funds management procedures have been developed and implemented. The bank's liquidity position is calculated on a weekly basis and is considered adequate as of examination date.

The external audit coverage has improved significantly and is now considered acceptable. . . .

The bank is in compliance with all articles of the Cease & Desist Order issued on November 20, 1980 except Articles I and IV.

SUPERVISION OF ADMINISTRATION BY DIRECTORS AND MANAGEMENT

The overall supervision of the bank's affairs by the Board of Directors is considered generally satisfactory at this time.

LOAN PORTFOLIO MANAGEMENT

The loan policy was reviewed and found to be suitable for the needs

of the bank. . . . The quality of the loan account has improved significantly and is considered fair. Loans subject to classification are 31.7% of gross capital funds compared to 61.6% at the May 4, 1981 visitation and 74.2% at the October 20, 1980 examination. When other loans especially mentioned are included, loans subject to criticism are 33.4% of gross capital funds compared to 64.9% and 79.4% respectively. Past due loans have
declined from 5.1% at the last visitation to 2.5% at this examination. Past due mortgages, a matter of concern at the visitation, have declined from $887,000 or 8.7% to $440,000 or 4.4%. Non-accrual loans have declined 37.4% from $537,000 to $336,000.

RESERVE FOR POSSIBLE LOAN LOSSES
(Valuation Reserve)

Improvement is noted in factors affecting reserve adequacy since the last examination. The bank has lower net loan losses, a lower delinquency level in the loan portfolio and a lower volume of classified loans at this examination. . . .

LIQUIDITY, ASSET AND LIABILITY MANAGEMENT

There has been improvement in the management of the asset/liability

structure of the bank. Using the Comptroller of the Currency formula, net liquid assets as a percentage of net liabilities was 17.05% as of October 30, 1981; 21.13% Nov. 30-81.

Management has made efforts to improve its monitoring of net interest margins. . . .

* * * *

INTERNAL CONTROLS

The bank's system of internal control is considered satisfactory. Since the previous examination many of the deficiencies cited have been corrected.

The bank requests the assistance and guidance of the Comptroller of the Currency in a mutual effort to resolve the bank's difficulties. The assessment of civil penalties against the bank would only serve to worsen the bank's financial condition and hinder the recent improvements in the bank's operations. Unlike counter-productive civil penalties, we welcome the Comptroller's cooperation so as to continue the bank's increased profitability and concurrent increase in capital.

On behalf of First National Bank of Scotia and its

Board of Directors,

Sincerely yours,

K. E. Buhrmaster
Chairman of the Board

KEB:cg
Enclosures

ADDENDUM J

Comptroller of the Currency
Administrator of National Banks

Second National Bank Region
1211 Avenue of the Americas, Suite 4250
New York, New York 10036
212-944-3495 (Regional Administrator of National Banks)

January 20, 1982

Mr. Louis H. Buhrmaster
President
First National Bank of Scotia
201 Mohawk Avenue
Scotia, New York 12302

Dear Mr. Buhrmaster:

We have received your letter dated December 17, 1981 in which you request this office to state what we consider "over-reliance" upon rate sensitive deposits and borrowings. There is no definitive guideline that determines the correct level of rate sensitive deposits and borrowed funds for banks as a whole. The level of that is reasonable for any bank is determined by a variety of factors that include its capital base, overall condition, and the effectiveness of management.

We recognize the progress that has been achieved in reducing your bank's reliance on rate sensitive funds. It is our position

that a prudent expansion of rate sensitive funds may be undertaken. The expansion must fall within the guidelines established by the bank's asset and liability management policy. Particular consideration should be given to the spread that may be earned on any funds that are taken and to matching them with assets of similar rate and maturity. It should be noted that Article I of the Cease and Desist Order which requires an 8% capital to asset ratio, places a further restriciton on liability expansion.

Please notify this office; in writing, on how nay additional rate sensitive funds will be invested. If you have any questions, please contact William P. Reinhardt (212-944-3503) of this office.

Very truly yours,

THOMAS W. TAYLOR
Regional Administrator

WPR:eld

ADDENDUM K

Comptroller of the Currency
Administrator of National Banks NR 82-18

Washington, D.C. 20219

FOR: Immediate Release

Contact: Leonora S. Cross
(202) 287-4280

DATE: May 26, 1982

Comptroller of the Currency, C. T. Conover today urged Congress to enact major deregulatory provisions of S. 1720; S. 2532, the recently revised Regulators" Bill; and s 2531, a capital assistance program for weekend financial institutions.

Testifying before the Senate Committee on Banking, Housing and Urban Affairs, Conover noted that the problems facing both banks and thrift institutions are serious. Some of the pressures are short term and may be mitigated by lower interest rates or an economic upturn, he said, but others will continue as the financial services industry moves from a regulated to a competitive environment.

While strongly supporting legislation to provide capital assistance to troubled institutions and to facilitate mergers across industry and state lines in extraordinary circumstances, he said that such legislation by itself would accomplish little. He urged Congress to address some of the fundamental

earnings problems experienced by banks and thrift institutions to allow them greater flexibility to compete.

Citing narrowing interest rate spreads as a significant problem, Conover urged Congress to provide for a federal preemption of state usury laws and due-on-sale prohibitions. He strongly supported the provisions of S. 1720 that would remove restrictions on real estate lending by national banks, increase lending limits, and liberalize restrictions on bank borrowings. He also endorsed expanded lending authority for thrift institutions, as well as increased securities powers for banking organizations.

"The phase-out of deposit rate controls, already under way, must be matched by an accompanying expansion of asset powers to enable depository institutions to adjust to deregulation and avoid earnings problems in the future," the Comptroller said.

Conover urged enactment of the revised Regulators' Bill as a tool needed by the federal agencies to deal more effectively with troubled institutions. This bill, he noted, will provide greater authority to authorize interstate and inter-industry mergers in emergency situations.

STATEMENT OF

C.T. CONOVER

COMPTROLLER OF THE CURRENCY

BEFORE THE COMMITTEE ON BANKING

HOUSING AND URBAN AFFAIRS

U.S. SENATE

MAY 26, 1982

Mr. Chairman, Members of the Committee, I am pleased to offer the views of the Office of the Comptroller of the Currency on the important legislative initiatives before you today. Since this is my first time to testify on these issues, I would like to begin by describing my understanding of the problems confronting depository institutions. In particular, I wish to make the following points:

- The problems are severe.
- They affect both banks and thrifts.

They are not transitory; while some of the pressures are short-term and may be partially mitigated by lower interest rates or an economic upturn, others will continue as the industry changes from a regulated to a competitive environment.

Before discussing my recommendations on the legislation before the Committee, let me briefly elaborate on these observations.

THE FINANCIAL MARKETPLACE IN TRANSITION

There are many pressures facing depository institutions today. Two key ones are well-known to this Committee and hopefully will be mitigated as economic conditions improve. The first is the impact on earnings of a rapid increase in interest rates on a maturity-mismatched portfolio like that of most thrift institutions and some commercial banks. The second problem is the decline in

the quality of depository institutions' assets. A growing number of companies -- large and small -- are experiencing financial difficulties, including bankruptcies. A decline in interest rates and an economic upturn would alleviate both these problems, although some depository institutions have already been so weakened that they may not survive.

Three even more serious problems will be faced by depository institutions for quite some time, however. These are:

- loss of low-cost deposits,
- high operating costs, and
- non-regulated competition.

Controlled low-cost core deposits have provided an effective subsidy in recent years that has been the source of a substantial portion of depository institutions' profits. Depository institutions are faced with a loss of this subsidy, which is virtually irreversible regardless of the deregulatory ap-

proach. Either core deposits will cost more as interest rate ceilings are lifted, or core deposits will leave the institution as customers seek higher rates elsewhere, forcing the institution to purchase market-rate funds. Furthermore, a decline in interest rates from today's levels will not eliminate the incentive of depositors to shift out of a 5-1/2 percent account, unless market rates decline to that range.

While Congressionally mandated deregulation of deposit rate ceilings is occurring at a slow pace, marketplace deregulation of deposit costs, spurred by consumer demands for higher returns, is occurring quite rapidly. So-called "sweep accounts" are a prime example of this phenomenon. But asset deregulation for depository institutions is, for the most part, still awaiting Congressional action. As a result, interest rate spreads are narrowing and severe pressure is being

felt on earnings. Continued inaction could substantially weaken our depository system.

The profitability of depository institutions has been further eroded by a dramatic increase in operating costs -- both in absolute amounts and in proportion to assets. These costs are an unfortunate legacy of a regulated environment that encouraged service competition rather than price competition, and inflation that drove salaries and expenses up. This high cost structure poses a serious competitive problem to depository institutions -- one that they cannot easily or quickly overcome.

These internal pressures are exacerbated by increased competition from other less regulated financial service companies, unburdened by high operating costs and unfettered by asset restrictions. Some of those companies are far better situated than our largest banking institutions to reach and

service the developing national marketplace.

LEGISLATIVE RESPONSES

The legislative proposals that are the focus of these hearings provide the regulatory authorities with broadened powers to assist weakened institutions through a capital assistance program and to authorize mergers across industry and state lines in extraordinary circumstances. While we support such emergency legislation, alone it will accomplish little. Legislative efforts should also address some of the fundamental earnings problems that I have described and allow institutions greater flexibility to compete.

* * * *

Capital Assistance Proposals

The proposed capital assistance program contained in S. 2531 is essentially an interim measure to enable well-managed institu-

tions to adjust and better compete in the future.

We believe that S. 2531 is superior to the approach adopted by the House. Among other things, the percentage-of-loss approach and use of the same eligibility criteria for all institutions (rather than a more lenient standard for commercial banks) are preferable. We also endorse the override of laws imposing criminal liability on directors who accept deposits after an institution's statutory net worth has fallen below a specified level, notwithstanding regulatory guarantees of net worth.

We do not believe, however, that federal assistance should be tied to the level of any particular type of loan previously made or to be made by a participating institution; such tying would amount to credit allocation that is in part the cause of our present problems.

Finally, because the legislation would

apply to commercial banks, clarification is needed of several technical aspects of the proposed program as it would affect national banks. This program creates some potential for overlap between the authorities of the FDIC and the OCC with regard to participating national banks. I trust that in cooperation with the FDIC we will able to work with the Committee in honing the finer details of this program.

CONCLUSION

In summary, our entire depository system has been weakened by continuing high interest rates and faces continued pressures during the transition to a deregulated environment. Temporary federal assistance to endangered institutions, as proposed in S. 2531, may be justified at this time; however, such assistance is not a solution to fundamental problems.

I strongly encourage the Congress to act to restore the long-term health of our depository institutions by providing adequate asset and liability powers. We, therefore, strongly endorse the enactment of the major deregulatory provisions contained in S. 1720.

Finally, we encourage the Congress to enact S. 2532, the so-called revised Regulator's bill, to permit the federal supervisory agencies to better maintain confidence in our despository system.

I would be happy to answer any questions.